STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of NUSCO, INC. AND PETER PORCELLI, AS OFFICER for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1985 through May 31, 1988.	: : : : : :	DETERMINATION DTA NO. 809581

Petitioners, Nusco, Inc. and Peter Porcelli, as officer, 376 Merrick Avenue, East Meadow, New York 11554, filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1985 through May 31, 1988.

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on February 26, 1992 at 1:15 P.M., with all briefs to be filed by May 15, 1992. Petitioners appeared by Roy J. Macchiarola, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

ISSUES

I. Whether petitioners have sustained their burden of proof to show that the audit method or amount of tax assessed was erroneous.

II. Whether petitioners have sustained their burden of proof to show that the failure to properly report and pay sales tax was due to reasonable cause and not willful neglect.

FINDINGS OF FACT

During the period at issue, petitioner Nusco, Inc. ("the corporation") operated a pizzeria and restaurant under the name "Sergio's" at 376 Merrick Avenue, East Meadow, New York. Petitioner Peter Porcelli was president and sole shareholder of the corporation.

The business was open seven days a week. The hours of operation were 11:00 A.M. to 10:00 P.M. Monday through Saturday, but 11:00 A.M. to a somewhat earlier closing hour on Sunday. The restaurant had a counter, tables and chairs and also provided a delivery service. The restaurant sold pizza, Italian food, soda and beer.

An audit of the corporation's books and records for the period March 1, 1985 through November 30, 1987 was commenced on February 1, 1988. The audit methodology and findings were as follows:

(a) The auditor requested all pertinent books and records. The records produced were sales tax returns and worksheets, Federal income tax returns, cash receipts worksheet and check disbursements worksheet. The corporation did not maintain cash register tapes or guest checks. Sales were found to have been based on bank deposits added to cash payouts. There was no internal control over the recording and reporting of cash or sales, or of purchases.

(b) Gross sales per records did not reconcile with sales reported on the Federal income tax returns and sales tax returns.

(c) Purchases per records did not reconcile with purchases reported on the Federal income tax returns.

(d) The auditor obtained third-party verification of the corporation's cheese purchases from C & F Dairy Co., Inc. for the quarter ending February 28, 1986. It was determined that the corporation purchased 5,764 pounds of mozzarella cheese during such quarter. The auditor noted that cheese purchases of $10,423.55 for the three months were greater than the corporation's total year's purchases per Federal income tax returns of $9,238.00.[1]

(e) The auditor also determined that the corporation purchased 1,550 pounds of cheese from another supplier, Napoli Foods, Inc., for the quarter ending November 30, 1986. This figure, however, was not used in the auditor's calculations.

(f) An observation of the corporation's business was conducted on April 19, 1988, a

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[1]The Federal income tax returns are not in the record.

Tuesday, from 11:00 A.M. to 8:30 P.M. Gross sales were $228.47, plus tax.[2] The soda and beer-to-pizza ratio was 20.93% and the meals-to-pizza ratio was 45.96%.[3] The average pizza price was found to be $7.08.

(g) The auditor used a recipe for a 12-inch pizza converted proportionately for an 18-inch pizza, calculating .63 pounds of cheese per pie, but actually used .75 pounds per pie at an average selling price of $7.08 per pie in the initial estimate.

(h) At a pre-assessment conference, petitioners' representative claimed that Sergio's was well known for its generous use of cheese, requesting that the auditor allow 1½ pounds of mozzarella per pie. The

auditor obligingly adopted the 1½-pound figure. Also, the price of each pie was reduced from $7.08 to $6.00, to reflect lower prices prevailing during the earlier portion of the audit period.

(i) Additional taxable sales were calculated as follows:

	Quarter Ending 2/28/86
Cheese purchased	5,764.00 lbs.
Less: 15% used for other meals	864.60 lbs.
2% for waste	115.28 lbs.
Net pounds used in pies	4,784.00 lbs.
Number of pies @ 1½ lbs. cheese per pie	3,189
Average selling price per pie	$ 6.00
Pie sales	$19,134.00
Meals @ 0.4596	$ 8,794.00
Soda & beer @ 0.2093	$ 4,005.00
Taxable Sales	$31,933.00

The corporation had reported taxable sales of $9,540.00 for said quarter; accordingly, additional taxable sales were $22,393.00 and the margin of error was determined to be 2.3473.

(j) The margin of error was applied to taxable sales reported for each of the quarters

[2]Exhibit "F", worksheets p. 23.

[3]Exhibit "F", worksheets, p. 24. It is noted that page 23 of the worksheets shows slightly lower ratios, apparently because the earlier calculation did not include luncheon specials for beer and soda and did not include calzone, sausage and "garlic knots" as meals.

in the period March 1, 1985 through May 31, 1988, resulting in tax due of $35,668.07.

(k) On June 8, 1988, Peter Porcelli, as president of the corporation, executed a consent extending the period of limitation for assessment of sales and use taxes for the period March 1, 1985 through February 28, 1986, to June 20, 1989.

On December 20, 1988, the Division of Taxation ("Division") issued notices of determination and demands for payment of sales and use taxes due to the corporation and to Peter Porcelli, as officer, in the following amounts:

Period	Tax	Penalty	Interest	Total
3/1/85 - 5/31/88	$35,668.07	$8,878.12	$8,188.94	$52,735.13
6/1/85 - 5/31/88 (omnibus penalty)	-0-	3,447.38	-0-	3,447.38

A Bureau of Conciliation and Mediation Services conference was held on May 15, 1990. Petitioners' representative produced invoices of C & F Dairy Co., Inc. for the period December 1, 1985 through May 31, 1988[4] and an analysis[5] purporting to show that the margin of error actually declined over the audit period, because cheese purchases fell while reported taxable sales increased, i.e.:

Quarter Ending	Pounds of Cheese Purchased	Reported Taxable Sales
2/28/86	5,764	$ 9,540.00
5/31/86	4,793	10,093.00
8/31/86	5,325	15,731.00
11/30/86	4,359	15,926.00
2/28/87	4,390	15,856.00
5/31/87	4,424	16,550.00
8/31/87	3,915	18,716.00
11/30/87	3,393	18,944.00
2/28/88	2,996	22,240.00
5/31/88	2,127	22,621.00

By conciliation orders dated August 31, 1990, the conferee denied petitioners' requests and sustained the assessments.

[4]Petitioner's Exhibit "3".

[5]Petitioners' Exhibit "2".

It was noted at the hearing that the analysis provided to the conferee and which was received in evidence at the hearing did not include the 1,550 pounds of cheese purchased from Napoli Foods, Inc. during the quarter ending November 30, 1986. Petitioners' representative was granted

until March 31, 1992 to submit additional invoices from Napoli Foods and amend the analysis, if necessary. Nothing, however, was submitted.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners' representative waived closing argument in lieu of submitting a brief or memorandum; however, no such brief or memorandum was submitted. It appears that petitioners' argument is that the books and records offered for audit were adequate; that if they were not adequate the Division could not estimate sales beyond those which would have been indicated by the observation test; and that the audit was unreasonable in that it failed to recognize that sales declined after the test quarter, because the test quarter was during a time when the business was in a promotional stage.

The Division counters petitioners' arguments by claiming that the books and records were inadequate, that the auditor could use both an observation test and third-party information in calculating taxes due and also that petitioners have not sustained their burden of proof to show that the method of audit or tax calculated was erroneous. The Division noted that petitioners have not shown that the C & F Dairy Co., Inc. invoices submitted (Petitioners' Exhibit "3") represented all purchases made by the corporation.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in pertinent part, as follows:

> "If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the commissioner of taxation and finance[6] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices, such as stock on hand,

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[6] Prior to October 1, 1987, the statute referred to the former State Tax Commission.

> purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service, number of employees or other factors."

B. If a vendor is unable to produce the records required to be kept under Tax Law § 1135, the Division is authorized by the above-mentioned section 1138(a)(1) to select a method of audit reasonably calculated to reflect the taxes due. It is then incumbent upon the vendor to show by clear and convincing evidence that the method of audit or amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451; Matter of Carmine Restaurant v. State Tax Commn., 99 AD2d 581, 471 NYS2d 402).

C. The records offered for audit here were clearly inadequate and insufficient, as the corporation failed to maintain cash register tapes or guest checks and there were no internal controls over the recording and reporting of cash or sales. Moreover, purchases per records could not be reconciled to the Federal income tax returns and the gross sales per records were not in agreement with sales reported on the Federal income tax returns and/or sales tax returns. Accordingly, the auditor was authorized to reconstruct the corporation's sales by use of external indices. The question, then, may be reduced to whether petitioners have sustained their burden of proof to show that the method of audit or amount of tax assessed was erroneous.

D. The audit methodology used by the Division was reasonable. The corporation's purchases of cheese for the test period were uncontroverted and the auditor used the very liberal 1½ pounds of cheese per pizza figure which was requested by petitioners' representative. The auditor used the observation test to determine the ratio of meals and drinks to pizza. The total sales for the day of observation, a Tuesday, does not reflect the true typical daily sales which, as the auditor pointed out, would in all probability have been substantially greater if Friday and Saturday sales were taken into consideration.[7] Petitioner offered no testimonial evidence and

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[7] It is also noted that the observation ended at 8:30 P.M., while the business was open six days a week until 10:00 P.M. The Sunday closing time, as noted earlier, is unknown.

the only documentary evidence offered was the collection of C & F Dairy Co., Inc. invoices for the period December 4, 1985 through December 29, 1988, which are virtually useless since it is known that for at least one quarter (the quarter ending November 30, 1986) the corporation received substantial additional cheese from a second supplier (see Finding of Fact "6"). Petitioners' argument that sales declined after the test quarter because promotional sales ended is particularly suspect. While petitioners claim that cheese purchases declined significantly during the audit, the reported taxable sales rose significantly (see Finding of Fact "5"; Petitioners' Exhibit "2"). Petitioners have clearly failed to sustain their burden of proof to show that the method of audit or amount of tax assessed was erroneous.

E. Petitioners have also failed to sustain their burden of proof to show that the failure to properly report and pay sales tax was due to

reasonable cause and not to willful neglect. As noted earlier, petitioners offered no testimonial evidence and the only documentary evidence offered was the C & F Dairy Co., Inc. invoices and analysis.

F. The petition of Nusco, Inc. and Peter Porcelli, as officer, is denied and the notices of determination and demands for payment of sales and use taxes due issued to petitioners on December 20, 1988 are sustained.

DATED: Troy, New York
April 8, 1993

/s/ Robert F. Mulligan
ADMINISTRATIVE LAW JUDGE